

# **ECONOMIC OUTLOOK AND REVENUE ESTIMATES FOR MICHIGAN**

**FY 2004-05  
AND  
FY 2005-06**



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# FOREWORD

The House Fiscal Agency (HFA) is pleased to provide this report to members of the Michigan House of Representatives. The report presents final General Fund/General Purpose and School Aid Fund revenue estimates for fiscal year (FY) 2003-04, revised revenue estimates for FY 2004-05, and initial revenue estimates for FY 2005-06. Estimates reported herein will be presented to the Consensus Revenue Estimating Conference on January 13, 2005, and will be used to facilitate the consensus estimating process.

This report includes HFA analyses of important factors that will affect state and national economies through the year 2006, estimates of the Countercyclical Budget Stabilization Fund, state compliance with the Constitutional State Revenue Limit, and year-end balance estimates for General Fund/General Purpose and the School Aid Fund.

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## EXECUTIVE SUMMARY

According to the National Bureau of Economic Research, the national economic recovery started at the end of 2001. Once the recovery began, high productivity gains outpaced economic growth, which dampened national employment. However, recent indications suggest that the labor market is catching up with other sectors of the economy. Since August 2003, when employment bottomed out, the national economy has posted an average gain of 154,800 jobs per month. Total non-farm employment now stands at 241,000 jobs below the March 2001 peak.

Michigan's wage and salary employment has generally trended downward since the beginning of 2001. In November 2004, Michigan's wage and salary employment fell by 12,000 workers. Over the last eleven months, Michigan lost, on average, 2,400 jobs per month.

### **U. S. Forecast**

*Real GDP growth* is forecast to increase 3.2% in CY 2005, down from 4.4% in CY 2004. Real GDP is forecast to grow 3.4% in CY 2006.

*Inflation*, as measured by the Consumer Price Index (CPI), is forecast to decline from 2.7% in CY 2004 to 2.5% in CY 2005 and 2.3% in CY 2006.

*Light vehicle sales* totaled 16.6 million units in CY 2003 and are forecast to increase slightly to 16.7 million units in both CY 2004 and CY 2005, before increasing to 16.8 million units in CY 2006. The import share of light vehicles is forecast to be 20.6% in CY 2005 and 20.8% in CY 2006.

The *national unemployment rate*, which was 6.0% in CY 2003, is forecast to decrease to 5.5% in CY 2004, 5.4% in CY 2005, and 5.3% in CY 2006.

*Interest rates on three-month T-bills* averaged 1.0% in CY 2003 and are forecast to increase to 1.4% in CY 2004, 2.4% in CY 2005, and 3.4% in CY 2006.

### **Michigan Forecast**

*Michigan personal income* increased 2.5% in CY 2003. The rate of growth will pick up to 2.8% in CY 2004, 4.5% in CY 2005, and 5.8% in CY 2006.

*Michigan's unemployment rate* was 7.3% in CY 2003 and is forecast to be 6.7% in CY 2004, 6.8% in CY 2005, and 6.5% in CY 2006.

*Inflation*, as measured by the Detroit Consumer Price Index, was 2.0% in CY 2003; it is forecast to decrease to 1.8% in CY 2004, then accelerate slightly to 2.4% in CY 2005 before dropping back to 2.0% in CY 2006.

### **State Revenues**

Final *total baseline GF/GP and SAF revenues* were \$18.5 billion in FY 2003-04, and are forecast to increase 2.5% to \$19.0 billion in FY 2004-05, followed by an increase of 3.6% to \$19.7 billion in FY 2005-06.

*Baseline revenues* do not include the impact of partial-year policy changes or certain policy changes that have only recently occurred. *Baseline estimates* are comparable across fiscal years and demonstrate the changes to state revenues that are driven by changes in the economy.

Final total actual GF/GP and SAF revenues were \$18.7 billion in FY 2003-04 and are forecast to increase \$95.6 million or 0.5% in FY 2004-05 and increase \$728.9 million or 3.9% to \$19.5 billion in FY 2005-06. Actual revenues capture the effects of all policy changes and represent resources available.

**Table 1** reports GF/GP and SAF revenues in terms of baseline and actual revenues. House Fiscal Agency's recommended revisions to estimates for FY 2003-04 and FY 2004-05 are reported in **Table 2** and **Table 3**.

**Table 1**  
**HFA REVENUE ESTIMATES**  
(Millions of Dollars)

	<b><u>Final</u></b> <b><u>FY 2003-04</u></b>	<b><u>HFA Estimate</u></b> <b><u>FY 2004-05</u></b>	<b><u>HFA Estimate</u></b> <b><u>FY 2005-06</u></b>
GF/GP	\$7,986.8	\$8,117.7	\$8,396.7
SAF	<u>10,529.7</u>	<u>10,865.5</u>	<u>11,272.4</u>
<b><i>TOTAL BASELINE</i></b>	<b>\$18,516.6</b>	<b>\$18,983.2</b>	<b>\$19,669.1</b>
GF/GP*	\$8,042.3	\$7,870.1	\$8,189.2
SAF	<u>10,615.5</u>	<u>10,883.4</u>	<u>11,293.2</u>
<b><i>TOTAL ACTUAL</i></b>	<b>\$18,657.9</b>	<b>\$18,753.5</b>	<b>\$19,482.4</b>

\*Approximately \$115 million of the FY 2005-06 amount is due to an increased earmarking to GF/GP (and decreased earmarking to the Medicaid Benefits Trust Fund) of the recently-enacted tobacco tax increase.

NOTE: Numbers may not add due to rounding.



**Table 2**  
**FY 2003-04 HFA RECOMMENDED REVISIONS**  
(Millions of Dollars)

	<u>December 2004 Consensus</u>	<u>January 2005 Final</u>	<u>Change Amount</u>
GF/GP	\$7,912.6	\$7,986.8	\$74.2
SAF	<u>10,466.1</u>	<u>10,529.7</u>	<u>63.6</u>
<b>TOTAL BASELINE</b>	<b>\$18,378.7</b>	<b>\$18,516.6</b>	<b>\$137.9</b>
GF/GP	\$7,968.1	\$8,042.3	\$74.2
SAF	<u>10,551.9</u>	<u>10,615.5</u>	<u>63.6</u>
<b>TOTAL ACTUAL</b>	<b>\$18,520.0</b>	<b>\$18,657.9</b>	<b>\$137.9</b>

*NOTE: Numbers may not add due to rounding.*

**Table 3**  
**FY 2004-05 HFA RECOMMENDED REVISIONS**  
(Millions of Dollars)

	<u>December 2004 Consensus</u>	<u>January 2005 Recommendation</u>	<u>HFA Recommended Revision</u>
GF/GP	\$8,086.2	\$8,117.7	\$31.5
SAF	<u>10,865.5</u>	<u>10,865.5</u>	<u>0.0</u>
<b>TOTAL BASELINE</b>	<b>\$18,951.7</b>	<b>\$18,983.2</b>	<b>\$31.5</b>
GF/GP	\$7,838.6	\$7,870.1	\$31.5
SAF	<u>10,883.4</u>	<u>10,883.4</u>	<u>0.0</u>
<b>TOTAL ACTUAL</b>	<b>\$18,722.0</b>	<b>\$18,753.5</b>	<b>\$31.5</b>

*NOTE: Numbers may not add due to rounding.*

***State Revenue Limit***

*Final total state revenues* are expected to be below the state revenue limit by \$4.7 billion in FY 2003-04 and are estimated to be under the limit by \$5.7 billion in FY 2004-05 and \$5.7 billion in FY 2005-06. Final calculation of the state revenue limit is performed by the Auditor General.

***Year-End Fund Balances***

The *year-end GF/GP balance* was \$0.0 in FY 2003-04, and estimated to be \$0.0 for FY 2004-05.

The *School Aid Fund year-end balance* was \$74.1 million in FY 2003-04, and estimated to be \$0.0 for FY 2004-05.

The *Countercyclical Budget Stabilization Fund year-end balance* was \$81.3 million in FY 2003-04 and is forecast to be \$86.1 million in FY 2004-05.





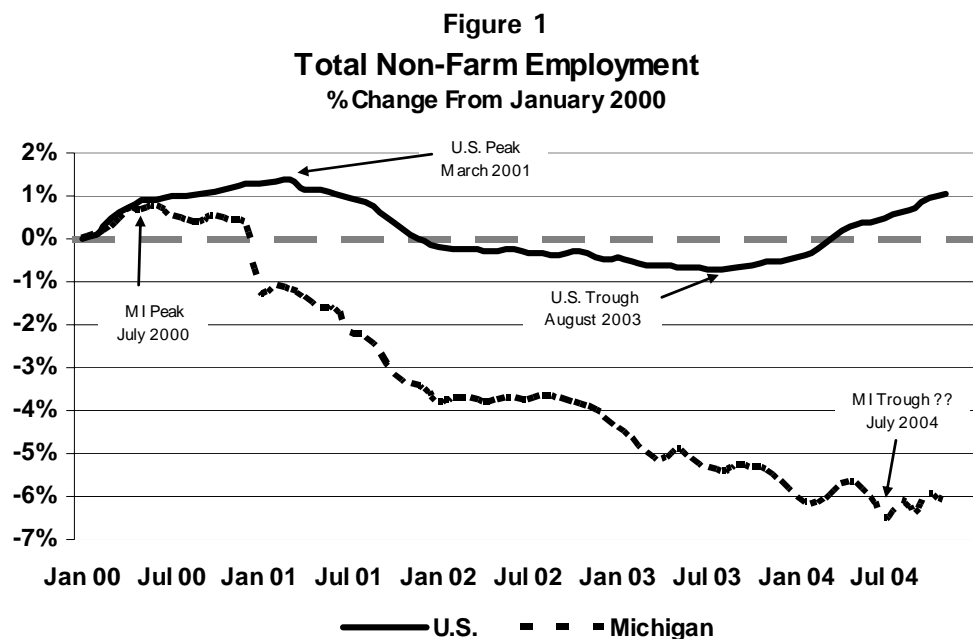
# ECONOMIC REVIEW AND FORECAST

This section presents the economic forecast used by the House Fiscal Agency to produce its updated revenue forecast for FY 2004-05 and initial revenue forecast for FY 2005-06.

The eight-month national recession that ended in November 2001 was followed by weak economic growth throughout CY 2002 and the early part of CY 2003. At the national level, economic growth accelerated at the end of 2003 and throughout 2004. Job growth at the national level has improved throughout CY 2004.

## **U.S. and Michigan Total Non-Farm Employment**

**Figure 1** shows the monthly percent change in total non-farm employment for both the U.S. and Michigan from January 2000 through November 2004.



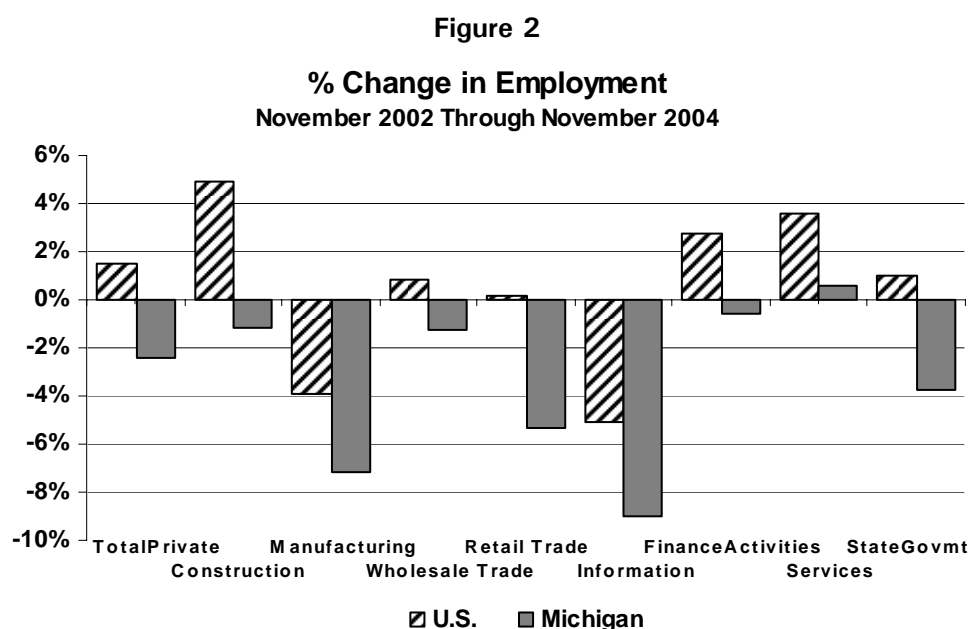
Employment in the U.S. reached a peak in March 2001, and began a long slide that did not bottom out until August 2003. During this 29-month period, the national economy lost more

than 2.7 million jobs, or about 93,700 jobs per month, on average. In the 16 months since August 2003, almost 2.5 million jobs have been added.

Although employment appears to be rebounding at the national level, conditions in Michigan are far less optimistic. Employment in Michigan peaked in July 2000, a full eight months before the March 2001 peak at the national level. Since the July 2000 peak, employment in Michigan dropped steadily until July 2004, resulting in a loss of more than 340,000 jobs—a 7.3% decline.

### **U.S. and Michigan Employment**

**Figure 2** shows the percentage change in employment over the past two years for all private workers, and several important sectors of the economy, for both the U.S. and Michigan.



Although the U.S. gained almost 1.7 million jobs over this period, employment in Michigan fell by almost 92,000 jobs—59.0% of which were in the manufacturing sector.

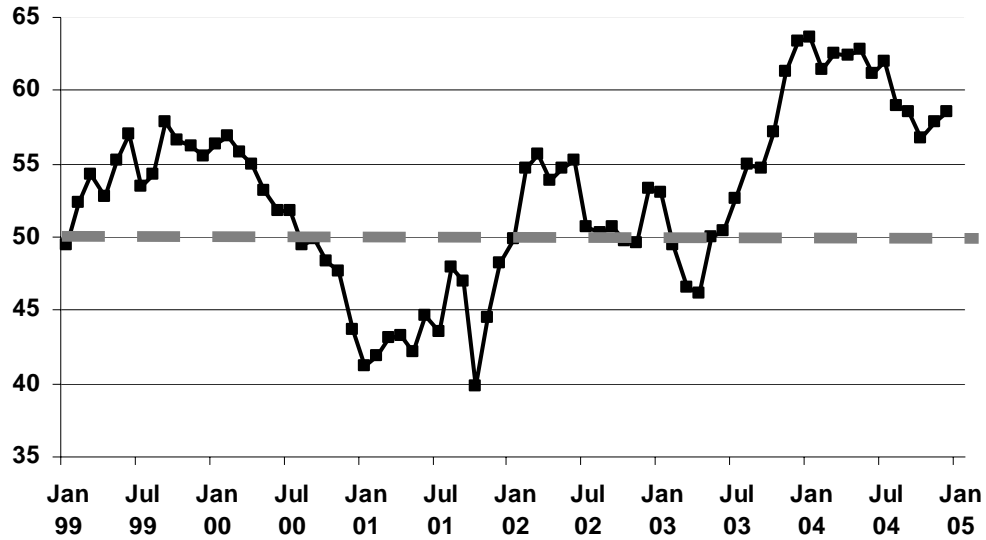
The U.S. experienced job gains in all sectors except manufacturing and information, while Michigan continued to lose jobs in all sectors except services. In all sectors, Michigan's job performance fell below that of the U.S.

### **Institute for Supply Management (ISM) Index**

**Figure 3** shows the (ISM) Index, a composite index of five economic indicators that is used to measure economic vitality, beginning with January 1999. An index number above 50 indicates a growing manufacturing sector, while a number below 50 suggests that the manufacturing sector is contracting.

The index reached a peak in December 1999, then fell below 50 in August 2000 and remained below 50 until February 2002. After peaking in June 2002, the index began to drop, and by September it had fallen below 50—where it remained before jumping to 54.7 in December.

**Figure 3**  
**Institute for Supply Management (ISM) Index**

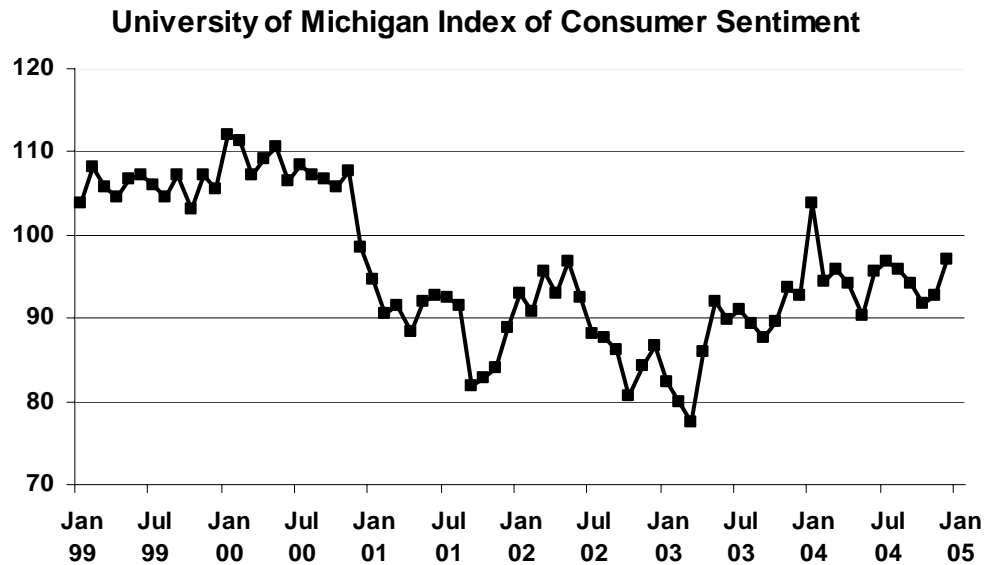


The ISM index started 2003 by falling for four consecutive months, then began a strong upward trend and finished the year at a 20-year high. During 2004, the index has generally declined—although it has increased each of the past two months.

**Index of Consumer Sentiment**

A somewhat similar story is portrayed in **Figure 4**, which shows the University of Michigan Index of Consumer Sentiment.

**Figure 4**



Consumer sentiment is a driving force behind personal consumption expenditures, which represent almost two-thirds of GDP. Even though the ISM index began to fall in early 2000, consumers remained cautiously optimistic about the economy.

The consumer sentiment index remained at historically-high levels throughout most of CY 2000, but dropped in December 2000 and continued falling until February 2001. Like the ISM index, consumer sentiment rebounded somewhat through August 2001 before plunging again in September 2001.

The index of consumer sentiment began 2003 with a three-month drop before rebounding in April and May. For the remainder of the year, the index generally followed an upward trend comprised of small monthly changes. After a large spike in January 2004 brought the index to over 100 for the first time in more than three years, consumer sentiment immediately dropped back in February and remained in the low- to mid-90s before ending 2004 with two consecutive monthly increases.

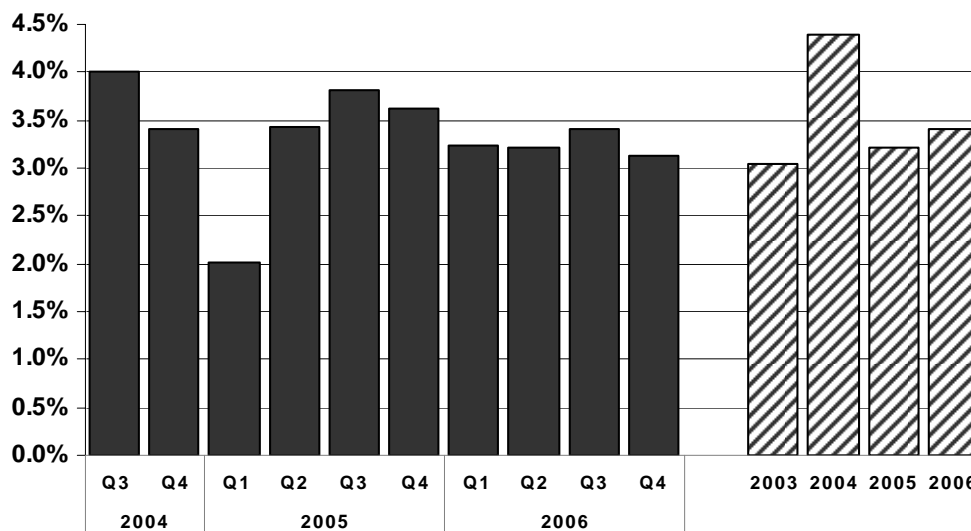
With the exception of the jump in January 2004, consumer sentiment has shown a very small upward trend dating back to May 2003. Although the ISM Index increased significantly during 2003, consumers remained much more cautious about the future of the economy—primarily because of weakness in the labor market.

### **Real GDP**

After rising by 3.3% during the second quarter of 2004, real GDP grew by 4.0% in the third quarter. *Real GDP* growth is forecast to be 4.4% in CY 2004 and 3.2% in CY 2005 before increasing by 3.4% in CY 2006.

**Figure 5**

### **% Change in U.S. Real GDP**



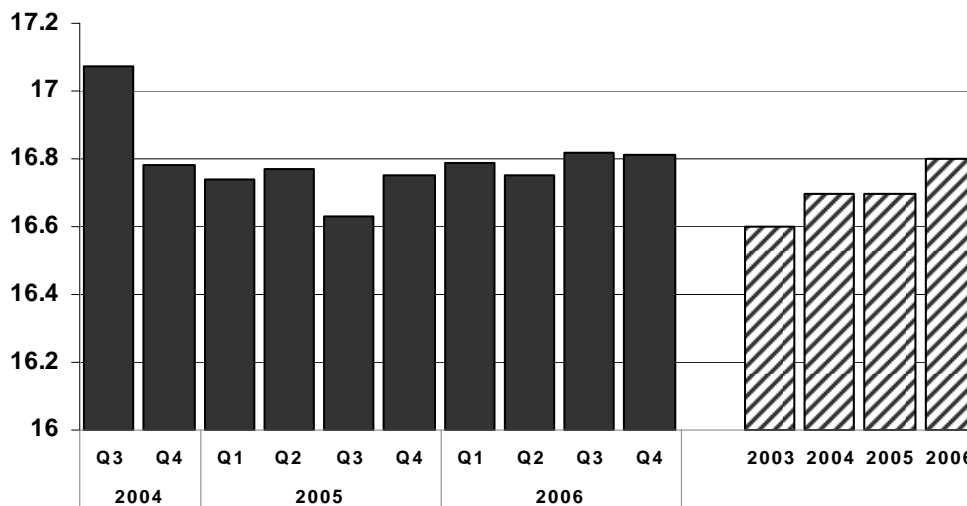
Personal consumption advanced 2.2% during CY 2003. As the economy picks up, this rate is estimated to grow by 3.6% in CY 2004. Personal consumption is predicted to increase by 3.4% in CY 2005 and 3.3% in CY 2006.

The GDP component showing the most significant improvement in CY 2004 has been private investment. After increasing at just a 0.6% rate during CY 2003, gross private domestic investment is expected to rise by 13.6% in CY 2004. Much of the expected growth can be attributed to increased expenditures on producers' durable equipment and information processing equipment and inventory rebuilding. Gross private domestic investment is forecast to increase by 4.4% in CY 2005 and 3.7% in CY 2006.

### **Light Vehicle Sales**

Rebates and special financing offers that began in the latter half of CY 2001 continued well into CY 2004. Despite incentives, sales of light motor vehicles in CY 2003 totaled 16.6 million units—well below CY 2000's record level of 17.2 million units. *Light vehicle sales* are anticipated to total 16.7 million units in both CY 2004 and CY 2005, and 16.8 million units in CY 2006.

**Figure 6**  
**Light Vehicle Sales**  
(Millions of Units)



Over the past several years, there has been a shift in sales away from cars and toward light trucks. This trend is expected to stabilize, and the share of light trucks is expected to remain roughly constant throughout the forecast period. *Light trucks* are expected to account for just under 56.0% of total sales in CY 2004, CY 2005, and CY 2006.

The *import share of total light vehicle sales* rose to 19.9% in CY 2003, and is forecast to increase slightly to 20.1% in CY 2004, 20.6% in CY 2005, and 20.8% in CY 2006.

### **Inflation: U.S.**

The overall increase in input prices (e.g., energy prices, wages, and import prices) has generally remained moderate and has helped to hold down production costs. Inflation is expected to remain low, by historical standards, through the forecast period.

Crude oil prices have jumped significantly over the past few months. Benchmark West Texas intermediate crude, which began 2003 near \$33 per barrel, spent most of the year hovering at about \$30 per barrel. Continued concern over the stability of the oil supply caused oil prices to reach an all-time high of almost \$52 per barrel in October 2004.

It is anticipated that oil prices will slowly drop throughout the forecast period, and average about \$41 per barrel during CY 2005 and about \$36 per barrel in CY 2006.

Annual rates of inflation, as measured by the percentage change in the *U.S. Consumer Price Index-Urban* (CPI-U), are expected to be 2.7% in CY 2004, 2.5% in CY 2005, and 2.3% in CY 2006.

### **Inflation: Michigan**

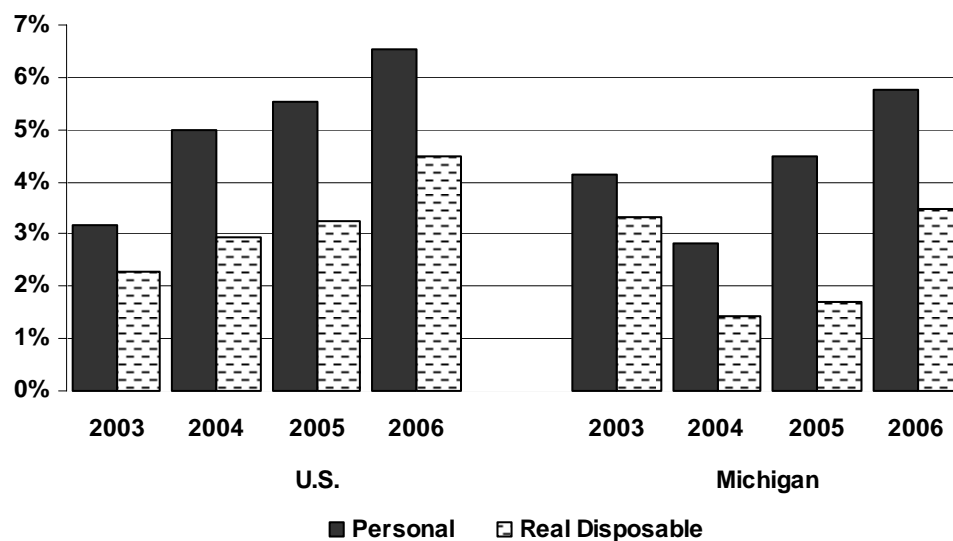
The cost of living in Michigan is measured by the *Detroit Consumer Price Index for Urban Consumers* (Detroit CPI-U). Michigan's average inflation rate was 2.0% in CY 2003. Inflation in Michigan is forecast to increase by 1.8% in CY 2004, 2.4% in CY 2005, and 2.0% in CY 2006.

### **Income Growth: U.S.**

Total *U.S. personal income* grew by 3.2% in CY 2003. Personal income growth is forecast to increase by 5.0% in CY 2004, 5.5% in CY 2005, and 6.5% in CY 2006.

Moderate growth in inflation contributed to a 2.3% growth of *U.S. real disposable income* in CY 2003. It is forecast that U.S. real disposable income growth will increase by 2.9% in CY 2004, 3.2% in CY 2005, and 4.5% in CY 2006.

**Figure 7  
Income Growth**





### **Income Growth: Michigan**

Michigan's total *state personal income* growth was 4.1% in CY 2003. It is forecast that Michigan personal income will increase by 2.8% in CY 2004, 4.5% in CY 2005, and 5.8% in CY 2006.

*Michigan real disposable income* grew 3.3% in CY 2003. In CY 2004, real disposable income is forecast to grow by 1.4% before picking up to 1.7% in CY 2005 and 3.5% in CY 2006.

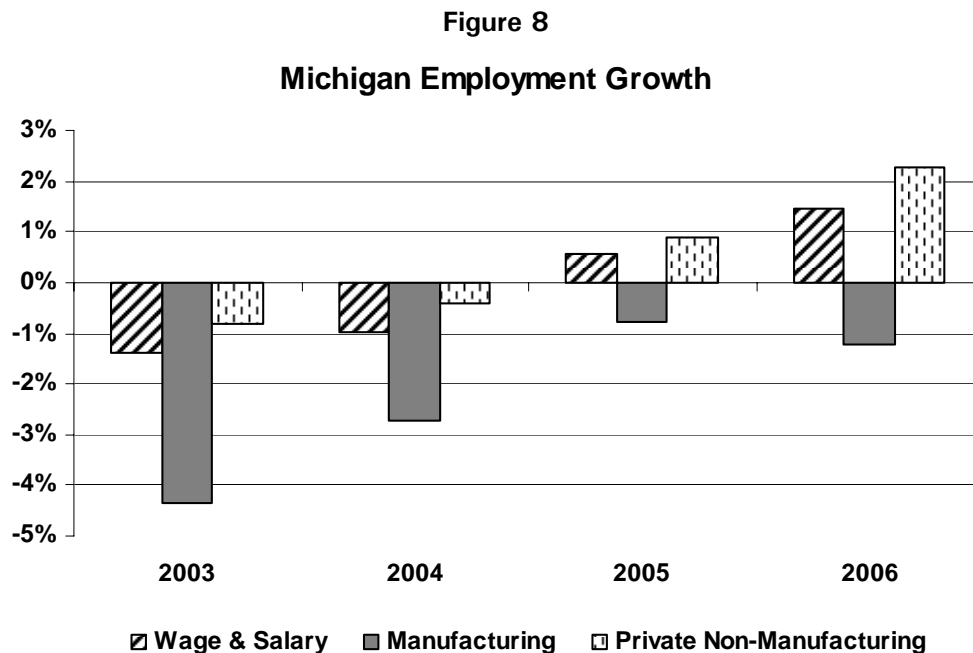
### **Employment: U.S.**

One critical factor underscoring the difference in income growth between the U.S. and Michigan is overall job growth. National employment has posted average monthly gains of almost 186,000 during 2004. U.S. non-farm employment is projected to increase by 1.5% in CY 2005 and 1.4% in CY 2006.

### **Employment: Michigan**

The Michigan economy has continued to endure a weak labor market, with an estimated decline of almost 42,000 workers in CY 2004. In CY 2003, wage and salary employment dropped by 1.4%; manufacturing employment declined by 4.3%, and private non-manufacturing employment fell by 0.8%.

The forecast calls for employment to begin growing slowly during the final quarter of 2004, posting a quarterly average gain of about 19,500. This growth, however, will not be enough to prevent a net loss of jobs for the year as a whole.



*Michigan wage and salary employment* is forecast to fall by 1.0% in CY 2004 before growing by 0.6% in CY and 1.5% in CY 2006.

*Michigan manufacturing employment* is forecast to drop by 2.7% in CY 2004, 0.8% in CY 2005, and 1.2% in CY 2006. Although the most significant declines are concentrated in the motor vehicle industry, employment declines also appear throughout the entire manufacturing sector.

*Michigan private non-manufacturing employment* is expected to decline by 0.4% in CY 2004 before growing by 0.9% in CY 2005 and 2.3% in CY 2006.

**Unemployment: U.S.**

Total non-farm employment has increased over the past 15 months, resulting in a decrease in the unemployment rate.

The *U.S. unemployment rate* is anticipated to be 5.5% in CY 2004, and is forecast to decline slightly to 5.4% in CY 2005 and 5.3% in CY 2006.

**Unemployment: Michigan**

Employment in Michigan remains a concern as job growth has fallen during the past four years. There are, however, signs that employment growth may be resuming. Michigan employment is forecast to expand very slowly throughout 2005, then accelerate in 2006. The combination of unemployed workers leaving the labor force and the aforementioned job growth should help to reduce the unemployment rate by CY 2006.

*Michigan's unemployment rate* is expected to be 6.7% in CY 2004 and 6.8% in CY 2005 before settling back to 6.5% in CY 2006.

**Table 4**  
**ECONOMIC FORECAST VARIABLES**

	<u>Calendar 2003 Actual</u>	<u>Calendar 2004 Estimated</u>	<u>% Change from Prior Year</u>	<u>Calendar 2005 Estimated</u>	<u>% Change from Prior Year</u>	<u>Calendar 2006 Estimated</u>	<u>% Change from Prior Year</u>
<b><u>United States</u></b>							
Real Gross Domestic Product (Billions of 2000 dollars)	\$10,381	\$10,839	4.4%	\$11,185	3.2%	\$11,566	3.4%
Implicit Price Deflator GDP (2000 = 100)	106.0	108.2	2.1%	110.4	2.1%	112.9	2.2%
Consumer Price Index (1982-84 = 100)	184.0	188.9	2.7%	193.5	2.5%	197.9	2.3%
Personal Consumption Deflator (2000 = 100)	105.5	107.8	2.2%	109.7	1.8%	111.7	1.9%
3-month Treasury Bills Interest Rate (Percent)	1.0%	1.4%		2.4%		3.4%	
Aaa Corporate Bonds Interest Rate (Percent)	5.7%	5.6%		5.7%		6.3%	
Unemployment Rate - Civilian (Percent)	6.0%	5.5%		5.4%		5.3%	
Light Vehicle Sales (Millions of units)	16.6	16.7	0.5%	16.7	0.0%	16.8	0.4%
Passenger Car Sales (Millions of units)	7.6	7.4	-2.8%	7.4	0.0%	7.5	0.9%
Light Truck Sales (Millions of units)	9.0	9.3	3.2%	9.3	-0.2%	9.3	0.4%
Import Share of Light Vehicles (Percent)	19.9%	20.1%		20.6%		20.8%	
Personal Income (Billions of current dollars)	\$9,162	\$9,618	5.0%	\$10,151	5.5%	\$10,815	6.5%
Real Disposable Income (Billions of 2000 dollars)	\$7,734	\$7,960	2.9%	\$8,217	3.2%	\$8,584	4.5%
<b><u>Michigan</u></b>							
Wage and Salary Employment (Thousands)	4,415	4,373	-1.0%	4,399	0.6%	4,462	1.5%
Unemployment Rate (Percent)	7.3%	6.7%		6.8%		6.5%	
Personal Income (Millions of current dollars)	\$314,460	\$323,292	2.8%	\$337,833	4.5%	\$357,294	5.8%
Real Personal Income (Millions of 1982-84 dollars)	\$172,267	\$174,062	1.0%	\$177,631	2.1%	\$184,102	3.6%
Real Disposable Income (Millions of 1982-84 dollars)	\$153,614	\$155,832	1.4%	\$158,478	1.7%	\$163,998	3.5%
Wages and Salary Income (Millions of current dollars)	\$176,493	\$177,680	0.7%	\$184,198	3.7%	\$193,033	4.8%
Detroit Consumer Price Index (1982-84 = 100)	182.5	185.7	1.8%	190.2	2.4%	194.1	2.0%
Detroit CPI (FY) (1982-84 = 100)	182.0	184.4	1.3%	189.3	2.7%	193.0	2.0%





# RISKS AND UNCERTAINTIES

An economic forecast is based on the best information available at the time the forecast is made. Because information and foresight are not perfect, risks and uncertainties are inherent in any forecast. The key risks in this forecast stem predominantly from uncertainties surrounding the labor market and productivity, the price of oil, intense competition in the motor vehicle industry, and retail trade sector uncertainties.

## **Labor Market and Productivity**

Recovery from the most recent national recession has been characterized by relatively anemic economic growth and high productivity gains with an extended weak labor market. While national wage and salary employment posted an average gain of almost 186,000 during CY 2004, Michigan wage and salary employment lost, on average, 2,400 jobs per month during the first eleven months of CY 2004.

Overall, Michigan's wage and salary employment has declined since the first quarter of CY 2001; the most recent data indicate that Michigan wage and salary employment has continued to trail downward. In November, the state's wage and salary employment fell by 12,000. Relative to a year ago, transportation equipment was down 7.5% and trade, transportation, and utilities, were down 2.6% (primarily due to retail trade).

Productivity increased 2.7% on average between 1998 and 2001. After increasing at 4.3% in CY 2002 and 4.5% in CY 2003, output per hour is estimated to increase 4.1% in 2004 and 2.5% in 2005. Businesses will continue to push for productivity increases, but increased hiring is expected to take over as the main factor in producing more output at the national level. Key to Michigan's job recovery, productivity gains in manufacturing and durable manufacturing have outpaced overall productivity—and this trend is expected to continue.

This forecast assumes that the national labor market will continue to improve, while Michigan employment will remain flat in the first quarter of 2005, then expand very slowly throughout the rest of 2005. Michigan wage and salary employment is expected to increase by only 25,500 jobs or 0.6% in CY 2005 and by 63,800 jobs or 1.5% in CY 2006.

If the labor market does not turn around as estimated, both the national economy and Michigan's economy could grow more slowly than anticipated and revenue growth would be adversely affected.

### **Oil Prices**

Oil prices are forecast to decline throughout 2005 and 2006 and are expected to average \$41 per barrel in CY 2005 and \$36 per barrel in CY 2006.. These prices are significantly higher than the previously-estimated long-term trend price of oil. Both strong global demand (especially in China) and supply shocks (attacks on Iraqi pipelines, political turmoil in Venezuela and Nigeria, and hurricanes in the Gulf of Mexico) have contributed to the recent high oil prices.

Oil prices affect the economy primarily through allocation of disposable income—because more income is used for energy (gasoline, fuel oil, and natural gas), less is used for all other items. Oil prices could fall below the estimated level, causing economic growth to be stronger than anticipated. On the other hand, oil prices may be higher than estimated, resulting in economic growth below the forecasted level.

### **Michigan's Motor Vehicle Industry**

The level and composition of light motor vehicle sales is a key component of Michigan's economy. Light vehicle sales were 16.6 million units in CY 2003 and are forecast to be 16.7 million in CY 2004 and CY 2005, before rising to 16.8 million in CY 2006. The import share of light vehicles was 19.9% in CY 2003 and is forecast to edge up slightly to 20.1% in CY 2004, 20.6% in CY 2005, and 20.8% in CY 2006. The value of the dollar relative to other currencies is expected to continue to decline, which will make import vehicles less attractive.

Although a higher level of domestically-produced motor vehicle sales would generally be considered positive for Michigan, the benefit to Michigan may not materialize. The 2004 market share of the big three auto manufacturers-General Motors, Ford, and DiamlerChrysler-declined to an all-time low of 58.7%. In addition, Michigan motor vehicle production declined 3.7% in FY 2002-03 and 4.9% in FY 2003-04.

Transplants (vehicles with a foreign nameplate that are made in the U.S.) have steadily gained in market share over the past several years. These transplants are expected to increase production capacity in the next few years, while the big three are expected to reduce capacity.

If the Michigan-produced market share of motor vehicles is less than anticipated, Michigan's economy and revenue growth will be lower than estimated.

### **Michigan's Retail Trade Industry**

The weak state labor market and pressures for productivity gains have contributed to retail trade employment losses in Michigan in the last few years. In each of the last four years, Michigan retail trade employment declined between 2.0% and 3.3%. In addition, the timing and location of any store closings or job reductions in Michigan due to the recent announcement of the Kmart-Sears merger have yet to be announced.

The degree to which retail trade employment is higher or lower than anticipated will affect state revenue growth.



## GF/GP AND SAF REVENUE

Revenue estimates are based on the economic performance of key components of national and state economies discussed in the preceding section. This section explains January 2005 House Fiscal Agency revenue estimates for GF/GP and School Aid Fund (SAF) revenue by major revenue sources. It provides revenue estimates, year-end balances for the major funds and the budget stabilization fund, and the state revenue limit calculation.

### **GF/GP Revenue by Source**

#### ***GF/GP Baseline Tax Revenues***

*Baseline GF/GP tax revenues* totaled \$7,661.2 million in FY 2003-04; they are estimated to increase \$182.9 million or 2.4% to \$7,844.1 million in FY 2004-05, and increase \$279.0 million or 3.6% to \$8,123.1 million in FY 2005-06.

#### ***Total GF/GP Baseline Revenues***

Total baseline GF/GP revenues include baseline tax revenues and non-tax revenues, such as federal aid, licenses and permits, and transfers from the liquor purchase revolving fund.

*Total GF/GP baseline revenues* were \$7,986.8 million in FY 2003-04; they are estimated to increase 1.6% to \$8,117.7 million in FY 2004-05, and increase 3.4% or \$279.0 million to \$8,396.7 million in FY 2005-06.

#### ***Actual GF/GP Revenues***

Actual GF/GP revenues take tax changes into account and are available for expenditure each year.

Final *actual GF/GP revenues* were \$8,042.3 million in FY 2003-04; they are forecast to decline 2.1% or \$172.2 million to \$7,870.1 million in FY 2004-05, and increase 4.1% or \$319.1 million to \$8,189.2 million in FY 2005-06.

Approximately \$115 million of the GF/GP increase in FY 2005-06 is due to an increased earmarking to the GF/GP (and decreased earmarking to the Medicaid Benefits Trust Fund) of the recently-enacted tobacco tax increase.

**SAF Revenue by Source****Total SAF Baseline Revenues**

Total *SAF baseline revenues* were \$10,529.7 million in FY 2003-04; they are forecast to increase \$335.7 million or 3.2% to \$10,865.5 million in FY 2004-05, and \$406.9 million or 3.7% to \$11,272.4 million in FY 2005-06.

**Actual SAF Revenues**

Actual SAF revenues take tax changes into account.

*Actual SAF revenues* totaled \$10,615.5 million in FY 2003-04; they are forecast to increase \$267.9 million or 2.5% to \$10,883.4 million in FY 2004-05 and increase \$409.8 million or 3.8% to \$11,293.2 million in FY 2005-06.

**Table 5**  
**GF/GP REVENUE ESTIMATES**  
(Millions of Dollars)

	Final			Fiscal Year 2005-06 over 2004-05	
	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>%Change</u>	<u>\$Change</u>
Personal Income Taxes	\$3,989.3	\$4,066.3	\$4,252.6	4.6%	\$186.3
Sales and Use Taxes	968.6	1,020.2	1,074.1	5.3%	53.9
SBT and Insurance Taxes	2,071.7	2,115.7	2,185.0	3.3%	69.3
Other Taxes	<u>631.7</u>	<u>642.0</u>	<u>611.4</u>	-4.8%	<u>(30.6)</u>
<b>GF/GP Baseline Tax Revenues</b>	<b>\$7,661.2</b>	<b>\$7,844.1</b>	<b>\$8,123.1</b>	<b>3.6%</b>	<b>\$279.0</b>
Non-Tax Revenue	<u>325.6</u>	<u>273.6</u>	<u>273.6</u>	0.0%	<u>0.0</u>
<b>Total GF/GP Baseline Revenues</b>	<b>\$7,986.8</b>	<b>\$8,117.7</b>	<b>\$8,396.7</b>	<b>3.4%</b>	<b>\$279.0</b>
Adjustments to Baseline	<u>55.5</u>	<u>(247.6)</u>	<u>(207.5)</u>	16.2%	<u>\$40.1</u>
<b>Actual GF/GP Revenues</b>	<b>\$8,042.3</b>	<b>\$7,870.1</b>	<b>\$8,189.2</b>	<b>4.1%</b>	<b>\$319.1</b>

*NOTE: Numbers may not add due to rounding.*



**Table 6**  
**SCHOOL AID FUND REVENUE ESTIMATES**  
(Millions of Dollars)

	Final			Fiscal Year 2005-06 over 2004-05	
	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>% Change</u>	<u>\$ Change</u>
Sales and Use Tax	\$5,155.9	\$5,340.6	\$5,564.7	4.2%	224.1
Income Tax Earmark	1,893.4	1,962.4	2,054.1	4.7%	91.7
State Education Tax	1,750.7	1,848.9	1,932.1	4.5%	83.2
Lottery/Casino Wagering	740.7	737.0	742.0	0.7%	5.0
Tobacco Taxes	479.6	472.7	465.2	-1.6%	(7.6)
Real Estate Transfer Tax	317.5	310.0	320.0	3.2%	10.0
Other Taxes	<u>191.9</u>	<u>193.8</u>	<u>194.3</u>	0.3%	<u>0.5</u>
<b>Baseline SAF Revenues</b>	<b>\$10,529.7</b>	<b>\$10,865.5</b>	<b>\$11,272.4</b>	<b>3.7%</b>	<b>\$406.9</b>
Adjustments to Baseline	<u>85.8</u>	<u>17.9</u>	<u>20.8</u>	15.9%	<u>\$2.9</u>
<b>Actual SAF Revenues</b>	<b>\$10,615.5</b>	<b>\$10,883.4</b>	<b>\$11,293.2</b>	<b>3.8%</b>	<b>\$409.8</b>

*NOTE: Numbers may not add due to rounding.*

**Table 7**  
**YEAR-END BALANCE ESTIMATES**  
(Millions of Dollars)

	Final <u>FY 2002-03</u>	Final <u>FY 2003-04</u>	Estimated <u>FY 2004-05</u>
General Fund/General Purpose	\$174.0	\$0.0	\$0.0
School Aid Fund	\$113.7	\$74.1	\$0.0
Budget Stabilization Fund	\$0.0	\$81.3	\$86.1

**HFA Estimates of Year-End Balances**

**Table 7** reports House Fiscal Agency estimates of year-end balances for GF/GP, the SAF, and the BSF.

*Fiscal Year 2004-05 estimates* are based on year-to-date appropriations and HFA revenue estimates. Final FY 2002-03 and FY 2003-04 figures are included.

*Budget Stabilization Fund estimates* are based on current balance estimates provided by the Michigan Department of Treasury and HFA estimates of future deposits and interest earned.

School Aid Fund revenues are restricted; hence, any year-end balance is carried forward to the subsequent year.

### **BSF Year-End Balances**

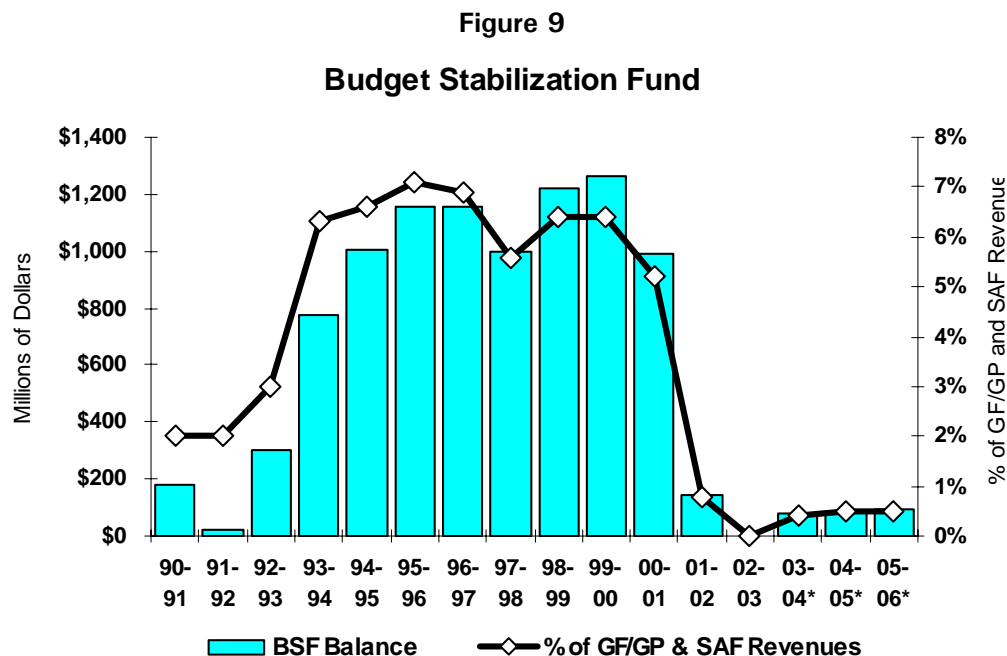
The Counter-Cyclical Budget and Economic Stabilization Fund (BSF), or the state's rainy day fund, is a reserve of cash to contribute to or withdraw from throughout the economic and budget cycles. **Table 8** shows deposits, withdrawals, interest earnings, and the year-end balance from FY 1989-90 through FY 2005-2006. **Figure 9** depicts the BSF fund balance and fund balance as a percent of total GF/GP and SAF revenues.

#### ***FY 2003-04***

Based on final FY 2003-04 data, the GF/GP year-end balance of \$81.3 million was transferred to the BSF.

#### ***FY 2004-05 and FY 2005-06***

The BSF trigger calculation, which is based on Michigan personal income less transfer payments adjusted for inflation, and actual or net GF/GP revenue, indicates no pay-in or withdrawal for FY 2004-05 or FY 2005-06.



**Table 8**  
**BUDGET STABILIZATION FUND HISTORY**  
(Millions of Dollars)

<u>Fiscal Year</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest Earned</u>	<u>Balance</u>
1989-90	\$0.0	\$69.9	\$35.8	\$385.1
1990-91	0.0	230.0	27.1	182.2
1991-92	0.0	170.1	8.1	20.1
1992-93	282.6	0.0	0.7	303.4
1993-94	460.2	0.0	11.9	775.5
1994-95	260.1	90.4	57.7	1,003.0
1995-96	91.3	0.0	59.2	1,153.6
1996-97	0.0	69.0	67.8	1,152.4
1997-98	0.0	212.0	60.1	1,000.5
1998-99	244.4	73.7	51.2	1,222.5
1999-2000	100.0	132.0	73.9	1,264.4
2000-01	0.0	337.0	66.7	994.2
2001-02	0.0	869.8	20.8	145.2
2002-03	0.0	156.1	10.9	0.0
2003-04	81.3	0.0	0.0	81.3
2004-05*	0.0	0.0	4.8	86.1
2005-06*	0.0	0.0	6.7	92.8

\* HFA Estimates NOTE: Numbers may not add due to rounding.

**Compliance With the State Revenue Limit**

Article IX, Section 26 of the *Michigan Constitution*, which was approved by the vote of the people in 1978, sets a limit on the amount of revenue collected by the state in any fiscal year. As provided for in the Constitution, the revenue limit is calculated as 9.49% of total state personal income (which is the broadest measure of state economic activity) in the previous full calendar year prior to the fiscal year in which the revenues are measured.

The revenue to be considered in the revenue limit includes not only state taxes, but also fees, licenses, and interest earned. Federal aid is not included in the revenue limit calculation.

Article IX, Section 26, *Constitution of the State of Michigan*, provides that:

. . . For any fiscal year in the event that Total State Revenues exceed the limit established in this section by 1% or more, the excess revenues shall be refunded pro rata based on the liability reported on the Michigan income tax and single business tax (or its successor tax or taxes) annual returns filed following

the close of such fiscal year. If the excess is less than 1%, this excess may be transferred to the State Budget Stabilization Fund . . . .

Furthermore, the state is prohibited from spending any current-year revenue in excess of the limit established in Section 26 by Article IX, Section 28.

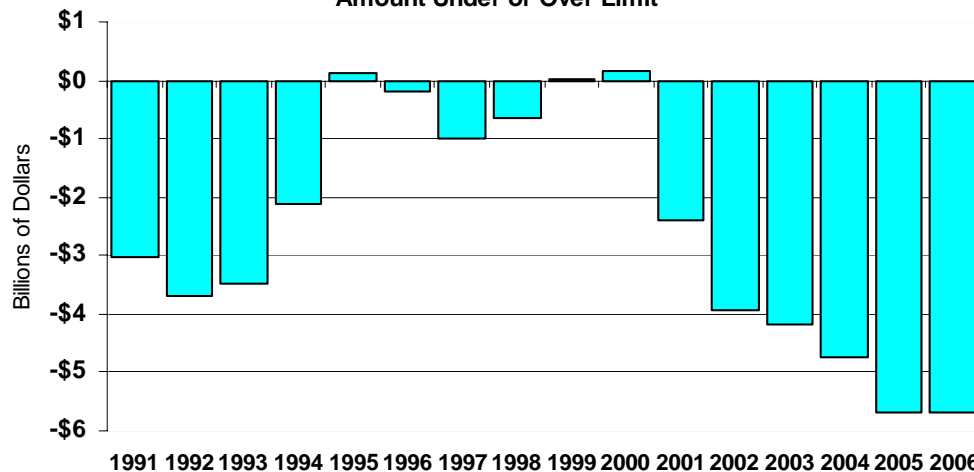
The final FY 2002-03 revenue limit calculation indicated that state revenue collections were \$4.18 billion below the revenue limit. In addition, for FY 2003-04 through FY 2005-06, state revenues are estimated to be substantially below the revenue limit, by \$4.74 billion, \$5.69 billion, and \$5.69 billion, respectively.

**Table 9**  
**COMPLIANCE WITH THE STATE REVENUE LIMIT**  
(Millions of Dollars)

<b><u>Revenue Limit Calculations</u></b>	<b><u>Final FY 2002-03</u></b>	<b><u>Preliminary Final FY 2003-04</u></b>	<b><u>Estimated FY 2004-05</u></b>	<b><u>Estimated FY 2005-06</u></b>
Personal Income				
Calendar Year	<u>CY 2001</u>	<u>CY 2002</u>	<u>CY 2003</u>	<u>CY 2004</u>
Amount	\$297,609	\$303,745	\$314,460	\$323,292
X Limit Ratio	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>
<b>State Revenue Limit</b>	<b>\$28,243.1</b>	<b>\$28,825.4</b>	<b>\$29,842.3</b>	<b>\$30,680.4</b>
Total Revenues Subject to Revenue Limit	<u>24,061.6</u>	<u>24,087.9</u>	<u>24,154.0</u>	<u>24,988.2</u>
<b>Amount (Under) Over State Revenue Limit</b>	<b>(\$4,181.5)</b>	<b>(\$4,737.5)</b>	<b>(\$5,688.3)</b>	<b>(\$5,692.2)</b>

*NOTE: Numbers may not add due to rounding.*

**Figure 10**  
**Constitutional Revenue Limit**  
Amount Under or Over Limit



\* Preliminary Final

\*\* HFA Estimate

**Table 10**  
**CONSTITUTIONAL REVENUE LIMIT HISTORY**  
**(Billions of Dollars)**

<u>Fiscal Year</u>	<u>(Under) or Over Limit</u>										<u>Fiscal Year</u>	<u>(Under) or Over Limit</u>
1979-80	(\$0.53)										1993-94	(\$2.11)
1980-81	(\$1.17)										1994-95	\$0.11
1981-82	(\$1.41)										1995-96	(\$0.18)
1982-83	(\$1.32)										1996-97	(\$0.98)
1983-84	(\$0.24)										1997-98	(\$0.64)
1984-85	(\$0.01)										1998-99	\$0.02
1985-86	(\$0.37)										1999-2000	\$0.16
1986-87	(\$0.84)										2000-01	(\$2.41)
1987-88	(\$1.35)										2001-02	(\$3.92)
1988-89	(\$1.03)										2002-03	(\$4.18)
1989-90	(\$1.76)										* 2003-04	(\$4.74)
1990-91	(\$3.04)										* * 2004-05	(\$5.69)
1991-92	(\$3.69)										* * 2005-06	(\$5.69)
1992-93	(\$3.48)											

\* *Preliminary Final*  
\*\* *HFA Estimate*



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